

# The Official Guide To Tokenized Securities



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Security Token Offerings will revolutionize the traditional finance world.



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Every new technology breakthrough allows entrepreneurs to either build new things or improve old things. One of the most important technology advancements in recent history is blockchain—officially defined as a digital ledger where transactions made in bitcoin or another cryptocurrency are recorded chronologically and publicly.

Blockchain has allowed for the creation of cryptocurrencies or “tokens” (which they will be called throughout this piece). According to the Swiss regulatory body FINMA, tokens can have three functions: Payment Tokens, Utility Tokens, or Asset Tokens (Security Tokens).

Payment Tokens are used as a means of currency or payment and Utility Tokens are intended to provide digital access to an application or service. While those are both interesting, this guide will serve to explain Security Tokens, the regulation that governs them, along with the advantages & disadvantages they bring. This is intended to be a living document that

will be updated from time to time with new resources, regulatory rulings, and other pertinent information.

## What is a Security Token?

Security Tokens are digital assets subject to federal security regulations. In layman terms, they are the intersection of digital assets (tokens) with traditional financial products—a new technology improving old things.

If cryptocurrencies like Bitcoin are considered “programmable money” then you can consider Security Tokens a version of “programmable ownership.” This means that any asset with ownership can and will be tokenized (public & private equities, debt, real estate, etc).

## Why are Security Tokens Important?

Security Tokens bring a number of improvements to traditional financial products by removing the middleman from investment transactions (usually some form of a banker). The removal of middlemen leads to lower fees, faster deal execution, free market exposure, larger potential investor base, automated service functions, and lack of financial institution manipulation.

**Lower Fees**—Many fees associated with financial transactions are derived from payments owed to middlemen (bankers, etc). Security Tokens remove the need for most bankers which reduces fees, and smart contracts may one day decrease the reliance on lawyers as well. These smart contracts will reduce the complexity, costs and paperwork with managing securities (collecting signatures, wiring of funds, mailing of distribution checks, collection of W-2s, Sending K-9s, etc).

**Faster deal execution**—The more people involved in a deal, the longer it usually takes to execute. When Security Tokens remove middlemen from investment transactions, they enable accelerated timelines for issuers to successfully offer their security. Additionally, immediate trade settlement on the secondary market for Security Tokens will become an attractive advantage for issuers & investors too.

**Free market exposure**—Most investment transactions today lack exposure to a global investor base. For example, it is hard for investors in Asia to invest in private US companies or real estate. With Security Tokens, asset owners simply market their deals to anyone with an internet connection (within regulatory limits). This free market exposure should lead to a significant change in asset valuations since any asset that is not exposed to a free market is mispriced.

**Larger investor base**—When asset owners can present deals to anyone with an internet connection, the potential investor base is drastically increased. For example, would you rather show your investment opportunity to only US accredited investors & institutions or every potential investor in the world? Competition is healthy and a long-term net good for financial markets.

**Automated service functions**—Lawyers are less middlemen and more service providers in most transactions. With Security Tokens, issuers will begin to use smart contracts to automate the service provider function through software. This doesn't mean that lawyers will disappear, but rather that their role will be more advisory based.

**Lack of financial institution manipulation**—This is a complex topic that is sure to be controversial. The short explanation is the likelihood for corruption and manipulation by financial institutions is decreased if those institutions are removed from the investment transaction process.

## **Are Security Tokens legally compliant?**

If you take away one thing from this guide, remember this: *When Security Tokens are done correctly, they don't skirt laws & regulations, they remove financial institutions and middlemen.*

This is because Security Tokens are subject to federal securities regulations—they are compliant from day one. There are three regulations in the Securities Act of 1933 that every person should be aware of when looking at US-based Security Tokens: Regulation D, Regulation A+, and Regulation S.

**Regulation D**—This allows an offering to avoid being registered with the SEC, but requires an electronic filing of "Form D" after the securities

have first been sold. The individuals offering the security may generally solicit investors for an offering that meets the requirements of Section 506c, which requires verification that the investors are accredited and the information provided during the solicitation must be “free from false or misleading statements.” In most cases, investors who purchase a Regulation D offering may not sell their ownership stake for at least 12 months after their initial purchase.

**Regulation A+**—This exemption allows an issuer to offer a security qualified with the SEC to non-accredited investors through general solicitation for up to a total of \$50,000,000 in investment. Due to the requirement to register the security, Regulation A+ issuance can take longer compared to other options. Regulation A offerings require qualification of a Form 1-A offering circular, including audited financials. Due to the requirement to qualify the security and complete an audit, Regulation A+ issuance can cost more and take longer compared to other options. Regulation A+ offerings treat all money raised as revenue and tax it as such if the money doesn't represent equity in the underlying company.

**Regulation S**—This is when an offering of securities is deemed to be executed in a country other than the US and therefore not subjected to the registration requirement under section 5 of the 1933 Act. Issuers of the security are still required to abide by the security regulations in each country where they offer their security.

*Disclaimer: The above summaries of US securities law, including Regulations A+, D, and S, are merely my personal opinion. They should not be construed as legal or investment advice and you should consult a lawyer for any and all questions you have.*

## **What are the disadvantages of Security Tokens?**

The removal of financial institutions from investment transactions is generally seen as advantageous by the crypto community but there are also a number of disadvantages & risks associated with it. When you remove middlemen, you have to shift the middleman's responsibilities onto the buyer or seller in the transaction.

Normally financial institutions serve a few functions: underwriting a deal, preparing marketing materials, soliciting investor interest, ensuring high levels of security & regulation compliance, and ultimately driving a successful execution of the transaction.

Security Token Offerings (STO) will require the issuer to underwrite their own deal via third party audits, prepare marketing materials, generally solicit investor interest, and have high confidence in their security & regulatory compliance. Many traditional investors believe that a large percentage of potential issuers are incapable of successfully executing these functions without traditional financial institutions. Time will tell who is right.

## Where can I learn more about Security Tokens?

Articles: [Traditional Asset Tokenization](#), [How Tokenization Is Putting Real-World Assets on Blockchains](#)

Platforms: [Securitize](#), [Templum](#), [Coinlist](#), [Open Finance](#), [tZero](#), [TrustToken](#)

Protocols: [Harbor](#), [Polymath](#),

Interesting projects: [Science Blockchain](#), [Spice VC](#), [22X Fund](#), [PropertyCoin](#), [Blockchain Capital](#), [Siafunds](#)

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